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TRUST AND DIVERSIFY: A GEOECONOMIC STRATEGY FOR THE AUSTRALIA-US ALLIANCE

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Cover photo: Australian Foreign Minister Julie Bishop and US Secretary of State John Kerry walk to a meeting at the US Department of State in Washington DC, 21 January 2015 (Getty)

EXECUTIVE SUMMARY

On September 1, 1951, Australia and the United States became formal allies. Seventy years later, they have built one of the world's closest military alliances, with leaders from both countries often noting their citizens have fought alongside each other in every major conflict of the last hundred years. Today, however, the most immediate strategic challenge to Australia, and perhaps also the United States, comes not from a military conflict, but from economic forces. In recent years, China has used a variety of economic tools to pressure Australia and other US allies and partners to accommodate Beijing and abandon policies to which its leaders object. Australia has stood firm amidst this coercive campaign, even though doing so has come at a cost. Rhetoric from Washington has consistently supported Canberra and has emphasised the need to cooperate with allies and partners on a range of "geoeconomic" policy challenges combining economic and security issues, such as supply chain resilience. But thus far, there have been few details about how to make this rhetorical support and commitment to international geoeconomic cooperation a reality. This report seeks to fill that gap.

AUSTRALIA AND THE UNITED STATES – AND THEIR ALLIES AND PARTNERS – NEED A COMMON FRAMEWORK FOR APPROACHING GEOECONOMIC COOPERATION. THE APPROACH ADVOCATED HERE IS A STRATEGY AIMED AT EFFORTS TO "TRUST AND DIVERSIFY."

Australia and the United States – and their allies and partners – need a common framework for approaching geoeconomic cooperation. The approach advocated here is a strategy aimed at efforts to "trust and diversify." The principle of *trust* recognises that certain trade and investment transactions must increasingly be based on reliable security and political relationships if they are to endure. At the same time, the concept of trust emphasises the need for the United States and Australia to remain respected contributors to an open global economic order, even as that order is necessarily reformed to reflect emerging geoeconomic realities. The principle of *diversification* acknowledges that mitigating risks emanating from untrusted economic partners will seldom involve simply closing off such relationships. Rather, a balance is more likely to be achieved by diversifying economic partners and thus reducing dependence on any single source. Although residual risks will remain, these will be more acceptable given the parallel interest in maintaining an open and rules-based economic system.

The need for greater trust and diversification derives from two underlying forces: leverage and fragility. Concerns about *leverage* arise because voluntary economic transactions are (by definition) mutually beneficial, and those valuable benefits, therefore, represent a potential source of power. If one party to a transaction is able to threaten or disrupt those benefits (at an acceptable cost to itself), it holds a valuable tool of influence. In the short term, leverage can be used coercively. In the long term, accumulated leverage represents influence, raising concerns when levels of trust are low or declining. Worries about *fragility* derive from the brittleness of globalised supply chains. The transnational fragmentation of supply chains has generally had positive effects: lower prices, higher living standards, and largely effective and responsive distribution networks. These benefits have, however, come with real downsides. In the short term, fragility can lead to global supply chain disruptions. In the long term, legitimate concerns about the presence of untrusted actors with leverage over critical supply chains can be exploited by protectionist elements, unless the relevant political dynamics are carefully managed.

Addressing concerns over leverage and fragility requires both trust and diversification. The Australia-US alliance is the perfect laboratory to pioneer these new mechanisms of geoeconomic cooperation. Canberra and Washington enjoy

deep integration across multiple domains, with the two nations sharing similar (but not identical) perspectives on the nature and scope of today's geoeconomic challenges. The structure of the two economies is relatively complementary, with fewer areas of competitive overlap compared with other advanced economies. And perhaps most importantly, the alliance offers an existing institutional framework and bureaucratic architecture that could be extended beyond the traditional focus on foreign and defence policy to integrate economic and financial expertise into a broader geoeconomic agenda.

Nonetheless, the Australia-US alliance is not – at the moment – postured to deal effectively with geoeconomic challenges. It has been rightly focused on security issues, and the two countries have a free trade agreement, but the relationship lacks the infrastructure and habits necessary to elevate strategic cooperation at the intersection of economics and security. We recommend that the allies take five steps to overcome these limitations and prepare the alliance for geoeconomic cooperation:

- *Expand AUSMIN to address geoeconomic issues:* At present, the 2+2 format of the Australia-US Ministerial Consultations (AUSMIN) has an overwhelming focus on the portfolios of the participating principals. Canberra and Washington should expand AUSMIN into a strategic and economic dialogue, into which the full range of geoeconomic policy issues would be incorporated. Future AUSMIN meetings should not simply be 2+2 summits of defence and foreign policy makers but should expand to 3+3 meetings including officials specifically focused on the economic, trade and financial domains.
- *Establish a joint working group on geoeconomic cooperation:* The two governments should also establish a working group on geoeconomic cooperation, incorporating officials from both the security and economic bureaucracies. The working group's first task would be to agree on the nature of the policy challenges by sharing information and assessments regarding each country's key areas of vulnerability. Shared baseline understandings could then feed back into

the AUSMIN process as a starting point for more challenging bilateral work on specific policy initiatives.

- *Develop a cooperative supply chain management agenda:* There is immense political pressure to strengthen supply chain resilience, but the challenge is translating this momentum into tangible policy outcomes. The alliance framework, enabled by an expanded AUSMIN and a working group on geoeconomic cooperation, would provide the institutional incubator to develop a more robust supply chain management agenda and could serve as the basis for future dialogues outside of AUSMIN.
- *Construct an attribution mechanism to identify coercion:* After establishing processes to form a shared conceptual framework, the next step should be to establish mechanisms to coordinate concrete action. The simple act of identifying economic coercion is a prerequisite to any response. Australia and the United States should, therefore, jointly develop principles and lead in the formation of a multilateral grouping that can identify when an economic decision or incident has crossed the line from "normal" competitive frictions into a geoeconomic coercion campaign.
- *Explore cooperative countermeasures against economic coercion:* Finally, specific countermeasures against cases of coercion would represent a later phase in cooperation. The first step would be harmonising national counter-coercion responses. In the long term, there remains scope for allied cooperation on a potential counter coercion fund. Although these efforts might not fully offset the losses from coercive actions, they would limit the damage and build trust among and between governments and the private sector by demonstrating political and economic solidarity against shared threats.

Australia and the United States have a unique opportunity – and an urgent responsibility – to update their alliance to deal with two emerging challenges of the 21st century: geoeconomic leverage and fragility. The strategy advocated here would aim to build trust while diversifying. The recommendations offer pathways to mitigate geoeconomic risks, thereby strengthening the alliance and serving as a model for broader cooperation. After all, Washington has promised not to "leave Australia alone on the pitch," so it is time that the alliance put its money where its mouth is.

THE CHALLENGES OF GEOECONOMIC LEVERAGE AND FRAGILITY

> *"The United States will not leave Australia alone on the field, or maybe I should say alone on the pitch, in the face of economic coercion by China."*
>
> **US SECRETARY OF STATE ANTONY BLINKEN, 13 MAY 2021**[1]

Australia and the United States enjoy one of the world's closest alliances, with leaders from both countries often noting that their citizens have fought alongside each other in every major conflict of the last hundred years. After 70 years of formal allyship, however, the most immediate strategic challenge to Australia, and perhaps also the United States, comes not from the military domain but the economic one.

In recent years, China has used a variety of economic policy tools as instruments of power and influence. Australia in particular has experienced a sustained campaign of economic punishment from Beijing arising from multiple political disputes. Canberra has stood firm amidst this coercive campaign, even though doing so has come at a cost. Rhetoric from Washington consistently supports Canberra and emphasises the need to cooperate with allies and partners on a range of geoeconomic policy challenges that combine economic and security issues, such as supply chain resilience. But thus far, there have been few details about how to make this rhetorical support and commitment to international geoeconomic cooperation a reality. This report seeks to fill that gap.

The following pages examine two related geoeconomic risks: leverage and fragility, explaining how they create conditions for economic coercion, influence accumulation, supply chain disruption and the propagation of protectionism. Addressing these four geoeconomic challenges requires efforts to rethink the structure of economic interdependence by capitalising on trusted economic relationships while adopting countermeasures built upon diversification. What is called for, in other words, is a new set of policies designed to build trust and diversification into the economic relationships of Australia and the United States. The recommendations presented here aim to establish a proactive and tangible geoeconomic agenda, which would not only bolster the Australia-US alliance but also serve as a starting point for other global partnerships in this emerging area of international cooperation.

The rise of geoeconomics

The concept of geoeconomics — a neologism coined by Edward Luttwak in 1990 — today represents two potent trends in foreign policy.[2] The first is the intentional use by national governments of economic policy instruments to project power and further geopolitical objectives. The second is the perception that "normal" economic behaviour — both by buyers and sellers in markets and by governments in regulating economies — can have substantial consequences for national security.[3] The unifying theme of geoeconomics is the increasing convergence of the economic and national security domains and the trade-offs policymakers face in balancing, often conflicting, national interests.

Neither of these trends is new. The strategic use of economic policy via the imposition of economic sanctions is as old as statecraft itself. Moreover, the regulation of market transactions that generate security side-effects is common historically, as exemplified by export control regimes during the Cold War, which were designed to keep sensitive military technology out of adversaries' hands. However, 21st-century globalisation has created economic interdependencies of unprecedented depth and complexity. These linkages are multiplying both the opportunities for governments to project power using economic levers and conversely the vectors

of perceived national security vulnerability.[4] In Washington, US leaders frequently assert that "economic security is national security" while in Canberra, experts write of the emergence of a "geoeconomic world order" in which the merging of economics and security is occurring amidst the backdrop of geopolitical rivalry between the major powers.[5]

The growth of security concerns about economic transactions and commercial relationships is due to two underlying forces that sit at the core of geoeconomic risk assessments: leverage and fragility. *Leverage* arises because voluntary economic and financial transactions are (by definition) mutually beneficial. Because those benefits are valuable, they represent a potential source of power. If one party to a transaction is able to threaten or disrupt those benefits (at an acceptable cost to itself), it holds a valuable tool of leverage or influence.[6] Accumulated leverage offers an instrument of coercion in the short term, which China (and the United States) have utilised in recent years.[7] Over the longer term, leverage is increased and accumulated via the acquisition of market power and network centrality.[8] The short-term possession and long-term accumulation of economic leverage raises concern when levels of trust in a political relationship are low or declining. Although leverage held by geopolitical rivals is of the greatest concern, leverage can also be an issue among allies and partners when their interests diverge.[9]

Fragility is a growing concern because shortages of essential goods during the COVID-19 pandemic exposed another trend – the increasing brittleness of globalised supply chains. The push for lower costs and higher profitability has resulted in the transnational fragmentation of supply chains. The consequences have generally been positive: lower prices, higher living standards, and largely effective and responsive distribution networks, which performed relatively well during much of the pandemic.[10] These benefits have, however, come with downsides. First, individual firms often have little visibility into their own supply chains and their associated risks. Second, the wider system is vulnerable to shocks, whether demand shocks such as the pandemic, or supply shocks such as natural disasters.[11] Political risks emanating from the presence of untrusted firms in supply chains or governments with leverage over critical linkages only contribute to the assessment that many supply chains are unacceptably fragile.

As concerns about leverage and fragility have grown, policymakers have sought to decrease the risk of each, often by pursuing economic closure, which represents a related risk to the current geoeconomic order. Efforts to mitigate threats of economic coercion, supply chain disruption, and influence accumulation have incentivised domestic policies that propagate protectionism. These protectionist policies threaten to feed a vicious international cycle and erode the long-term durability of the rules-based trading system that has served the world so well in recent decades.

Figure 1: Four geoeconomic challenges

	Short term	Long term
Leverage	**Economic coercion**	**Influence accumulation**
Fragility	**Supply chain disruption**	**Protectionist propagation**

Economic coercion

Of the four challenges listed above, economic coercion is perhaps the most urgent, at least as seen from Canberra. Since May 2020, multiple Australian industries have experienced major disruptions in their exports to China, with no end in sight. Diplomats from China summarised a list of 14 grievances with Australia in November 2020, which included issues such as Australian foreign investment review decisions, funding a so-called

"anti-China think tank," and making a statement on China's claims in the South China Sea.[12] These diplomatic grievances were aired amid mounting trade embargoes on multiple Australian exports to China, such as barley, beef, coal and wine. Beijing is certainly not the only actor engaged in economic coercion – in fact, the United States has long been the lead innovator in the application of economic leverage – but China's use of economic coercion presents Australia with its greatest strategic challenge in years. It is imperative the alliance is capable of meeting it.

Australia's experience fits within a broader pattern of foreign economic coercion practised by Beijing over more than a decade.[13] China's leaders previously tended to use coercive economic measures defensively, deployed in response to perceived violations of China's core national interests, namely "state sovereignty, national security, territorial integrity and national reunification…China's political system established by the Constitution and overall social stability, and the basic safeguards for ensuring sustainable economic and social development."[14] Some of the more high-profile cases include the disruption of outbound tourism to South Korea and rare earth element exports to Japan, restrictions on imports of Norwegian salmon and Filipino bananas, and regulatory crackdowns on South Korean supermarkets operating in China.[15]

The logic of this form of statecraft is "to impose economic costs on a target in pursuit of strategic objectives or to influence a foreign government, group, or individual to offer policy concessions."[16] Importantly, the underlying goal of economic coercion is to change policies in other domains, whether in the target entity itself or among third parties, which is what differentiates it from trade wars. Common tools include import and export restrictions, fomenting popular boycotts, investment restrictions, direct pressure on specific companies, restrictions on tourism and students, and individually targeted financial measures. In the case of China's economic punishment of Australia, Beijing's coercive pressure is likely intended both to force Canberra to adjust its foreign and security (including domestic) policies and to deter other countries from following Australia's lead.

Beijing's economic coercion typically differs from the practice of traditional economic sanctions.[17] Economic disruptions are seldom implemented through formal legal frameworks or publicly acknowledged as coercive acts.[18] Indeed, Chinese officials consistently deny any intentional coercion is occurring, claiming either that frictions are caused by other regulatory failings (such as health and safety standards, labelling or paperwork) or by the "patriotic" actions of Chinese consumers.[19] In its dispute with Australia, for example, China has imposed anti-dumping and anti-subsidy duties on Australian exports of barley and wine; asserted inspection failures on exports of red meat, timber and lobster; and refused to allow Chinese steel mills and utilities to use Australian coal.[20] In the context of deteriorating bilateral relations, most target states have little doubt that such disruptions have some coercive intent, despite periodic denials by Chinese officials.[21]

BEIJING IS CERTAINLY NOT THE ONLY ACTOR ENGAGED IN ECONOMIC COERCION – IN FACT, THE UNITED STATES HAS LONG BEEN THE LEAD INNOVATOR IN THE APPLICATION OF ECONOMIC LEVERAGE – BUT CHINA'S USE OF ECONOMIC COERCION PRESENTS AUSTRALIA WITH ITS GREATEST STRATEGIC CHALLENGE IN YEARS.

The informality common in China's use of economic coercion confers plausible deniability that pressure is even being applied, which offers several strategic benefits. First, this makes it harder to attribute coercive actions, and indeed even identify them, thus hindering the capacity of targets to respond. In particular, it minimises the risk of legal challenges and countermeasures under international trade and investment law, for which state responsibility must be established.

Informality can also reduce diplomatic fallout and reputational damage while offering the sanctioning state flexibility to wind back sanctions without acknowledging failure.[22] Informality also obscures the precise motives behind the sanctioning activity. The publicly stated objective of formal sanctions is usually changing the target's behaviour, but Beijing's informal sanctions often have other motives. These include protectionist impulses that contribute to industrial policy goals, and national security logics, such as China's efforts to diversify import sources to reduce over-reliance on any single foreign supplier.[23]

Recently, however, leaders in China have become bolder as they have expanded, intensified and clarified their use of coercive economic measures, especially in the absence of clear, consistent and united condemnation from the international community. Beijing has proven more willing to publicly challenge developed economies, including US allies such as Australia, Japan, South Korea, the United Kingdom, Canada and Germany. China has even formally sanctioned Trump administration officials – including at the cabinet level – and a range of European experts and politicians, as both a penalty and a warning to individuals who support policies against China's interests.[24] Echoing its actions in Canberra, Beijing recently gave Deputy Secretary of State Wendy Sherman two lists of complaints, one focusing on general US policies Beijing dislikes and another list with individual cases Beijing disagrees with.[25] In many of these cases, Beijing has used economic pressure to force foreign companies and individuals to adhere to China's preferred policies on supposed "sovereignty issues," such as Taiwan or Hong Kong.[26] And as Beijing's coercive economic targets have expanded, so too has its toolkit. China's leaders have revised the state's legal and regulatory frameworks to give the veneer of formality and legality and provide more options for retaliation against countries, companies, and individuals that challenge Beijing. They have also expanded the jurisdiction of these new regulations to be extraterritorial in nature, challenging Western policies and sharpening the trade-offs facing companies that want to operate in both Chinese and foreign markets. Recent policies include the creation of an unreliable entities list, a corporate social credit system and updates to China's export control regime.[27]

Influence accumulation

Short-term economic coercion is only one half of the challenge created by economic leverage: the other is long-term influence accumulation. The accumulation of economic influence can

shape national, corporate and individual decisions, even when economic coercion is not actively executed. By enhancing leverage, a foreign state or business can indirectly influence foreign actors, which may alter their choices on key strategic issues.[28] This type of influence accumulation is particularly challenging to deal with because it may not be apparent – the targets themselves may not even recognise these forms of indirect influence are actively shaping their decisions. Furthermore, accumulating influence is not an inherently nefarious activity, so it is difficult to identify when a cooperative economic relationship is creating unacceptable strategic risks.

Examples of influence accumulation abound in everyday life. What differentiates mutually beneficial cooperative relationships from potentially risky ones is the degree of trust between the two parties. As discussed in more detail below, trust represents a set of expectations about the future behaviour of another actor. When trust is high, even large amounts of accumulated leverage are likely to be perceived as low risk. Conversely, when trust is low, relatively small dependencies may create substantial risk. Although symmetrical economic interdependence between two parties can increase trust, asymmetrical interdependence can spark concerns about influence accumulation.[29]

From this perspective, the close ties between China and both the Australian and US economies pose several risks. China has substantial leverage due to its market size, including its position as a global manufacturing centre and as a large consumer market. Yet, despite its important economic position, mutual trust levels are relatively low and declining, which increases concerns about influence accumulation. As the volume of trade rises and the number of alternative trade partners declines, leverage accumulates and, with it, fears about economic coercion. Elsewhere around the world, dependence on China for everything from rare earths elements to 5G networking infrastructure is generating concerns that accumulated influence could be translated into coercion. And if China continues to grow as a market, Beijing will continue to have more leverage over foreign companies that sell and operate there, as well as their host countries. In an April 2020 speech later published in the party journal *Qiushi*, Xi Jinping framed the issue in defensive terms, saying China should "tighten the dependence of the international industrial chain on China, and form a strong countermeasure and deterrent ability for outsiders to artificially cut off supply."[30] Despite Xi's framing, accumulated leverage could, however, be used defensively or offensively.

Beijing is also upgrading its institutional capability to use accumulated influence. As noted above, China has created an unreliable entities list "to severely punish companies that have undermined China's national interests," which captures actions that pose a threat to the "national security, security, or development interests of China."[31] The threat of being added to the unreliable entities list and the loss of access to China's market represents a new tool that allows Beijing to penalise not only efforts to rebuff coercion, but even to protect against the accumulation of leverage, such as limiting Huawei operations in a foreign country. Another tool that China has created is the corporate social credit system, which seeks to use big data to monitor private organisations' behaviour and to reward or punish their actions. Although the system's primary use is to ensure that businesses are adhering to Chinese law and regulations, it can also be used to enhance the government's ability to penalise domestic and foreign companies – and their business partners – that undermine Beijing's interests.[32] Companies that get negative corporate social credit system ratings will be subject to increased restrictions on their business activities, such as being put on blacklists and publicly named and shamed.

Beijing has also recently updated its export control system, with a new Export Control Law which came into effect in December 2020.[33] The new law grants the central government more control over where and when it can enact export controls and expands the jurisdiction that Beijing claims over global supply chains.[34] The new export control regime purports to be global in reach, with Beijing claiming it has the jurisdiction to apply China's new export control regulations to any entity or individual that acts contrary to China's core national interests. Therefore, any company or individual in the world that is perceived to endanger China's national security can now be subjected to investigation and held legally liable in China. Potential punishments include large fines, revocation of export licenses and possible criminal charges.

Beijing is also increasing control over the private sector by further empowering the role of party organisations, or party cells, in businesses.[35] Party cells in private domestic and foreign enterprises essentially allow the state to play a formal role in the business decisions of private companies and could force foreign businesses to adhere to Chinese policies that contradict policies issued by their home countries.[36] In some cases, Beijing has forced foreign businesses to choose between Chinese policies and those of their home countries by placing pressure on them to not comply with their country's policies toward China for fear of being sued for damages.[37] The possible punishments are expansive, including visa restrictions and deportations, freezing of assets, prohibition of transactions and other "necessary" measures. Relatives, spouses and organisations can also be held responsible for the person who is placed on the countermeasures list. This expansion of China's legal and regulatory framework substantially increases the means through which Beijing can leverage its accumulated leverage over foreign companies.

PARTY CELLS IN PRIVATE DOMESTIC AND FOREIGN ENTERPRISES ESSENTIALLY ALLOW THE STATE TO PLAY A FORMAL ROLE IN THE BUSINESS DECISIONS OF PRIVATE COMPANIES AND COULD FORCE FOREIGN BUSINESSES TO ADHERE TO CHINESE POLICIES THAT CONTRADICT POLICIES ISSUED BY THEIR HOME COUNTRIES.

Supply chain disruption

Although the leverage-related risks to Australia and the United States largely emanate from abroad, fragility-related risks arise from both domestic and international concerns. The COVID-19 crisis demonstrated to many just how dependent economies have become on global supply chains, particularly for personal protective equipment, pharmaceuticals and advanced medical equipment. Transnational production chains can be remarkably efficient, but this efficiency comes at some cost, namely the risk of supply chain disruption.[38]

Protecting against supply chain disruption has become a major objective of governments.[39] In Washington, a central priority is supply chain resilience – ensuring that the United States maintains secure and reliable sources of critical goods, services and production inputs. Shortages brought about by the pandemic created the political will for greater government involvement in mitigating these risks. In June 2021, the Biden administration issued Executive Order 14017, which focuses on a number of areas: critical medicines, advanced batteries, critical minerals and semiconductors.[40] This effort includes the establishment of a task force dedicated to supply chain disruptions, which has been tasked to "focus on areas where a mismatch between supply and demand has been evident: homebuilding and construction, semiconductors, transportation, and agriculture and food."[41] These actions suggest that Washington will increasingly look to onshore production in these areas, or at least decrease dependence on some foreign suppliers.

Although many governments, including the United States, have often taken a *laissez-faire* approach to global value chains, this is no longer the case. Republicans who long opposed industrial policy are embracing a greater role for the state in maintaining supply chain resilience. Amid growing rivalry with China and the reality that Beijing is itself engaging in a drive for self-sufficiency, there is a growing bipartisan assessment that the United States is too reliant on Chinese (and other foreign) sources for certain critical goods and must increase its own competitiveness in these and other areas.[42] Similar debates are occurring in Australia, due not only to the pandemic but also motivated by China's recent economic pressure. Although recent research highlights the complexity of supply chain resilience policies and advocates for targeted and cost-conscious measures that are sensitive to cross-border side effects, many policies to date have jettisoned these principles for political expediency, thereby risking ineffectiveness, waste and political backlash.[43]

A major challenge for Australia, the United States and other countries is to identify the areas in which they most need to protect against risks of supply chain disruption and to specify which countries they are comfortable involving in various supply chains. Not surprisingly, different governments around the world have very different views, based in no small part on their particular economic and security situations. Although some countries have advocated a "small yard, high fence" model in which supply chains would be highly protected, but only in only a small number of crucial sectors, rent-seeking behaviour encourages the expansion of these categories. In this case, countries may choose to protect many areas simultaneously, effectively jettisoning scalpels for sledgehammers. This could enable protectionism, a risk that is addressed below.

Protectionist propagation

A natural response to concerns about economic coercion and supply chain disruptions is to rely more on domestic production. Indeed, in the wake of the pandemic, political leaders across the globe have put restrictions on exports of everything from pharmaceutical precursors for vaccines to exports of certain advanced microchips. Although some short-term countermeasures are no doubt needed to mitigate heightened risks in overly fragile systems, these policies must be balanced by parallel long-term efforts to reinforce the integrity of the rules-based trading order. Otherwise, protectionist policies will propagate globally, damaging economies and potentially exacerbating the very concerns about economic coercion and supply chain disruptions that inspired the initial actions. Geoeconomic policy interventions must therefore be targeted at the precise source of security concern – mitigating risks – while preserving an open economic system as much as possible.

It is clear that the high degree of openness characterising the immediate post-Cold War period is no longer sustainable. This is not simply because of geoeconomic forces, but also an intense and transnational backlash against a neoliberal economic model perceived to be failing middle and working classes.[44] Yet there is a real danger of overcorrection. A dramatic unwinding of economic openness would be a cure far worse than the disease. And a drive toward autarky via large-scale onshoring of production would cause massive declines in international trade and investment. It would shift, rather than eliminate, inherent fragilities in supply chains, creating different bottlenecks and vulnerabilities to onshore disruptions such as natural disasters. Moreover, while it might reduce coercive leverage, the consequence of doing so would be to reduce economic output by more than any coercive activity could, while also undermining an

international economic order that has generated much global prosperity.

Despite their revealed fragility, globalised supply chains are a triumph of the post-war rules-based economic order, having facilitated the low-cost mass production of goods within stable regulatory frameworks for businesses. Efforts by national governments, individually or in groups, to reduce fragility in their supply chains may cause unintended economic side effects in non-participating countries.[45] For example, when one country reduces its imports in a sector, this will likely mean reduced market share for a foreign exporter. Accordingly, if supply chain policies are perceived as protectionist by other governments, those governments could retaliate with their own reciprocal measures. Each retaliatory policy weakens the international trading system, which occurs during a trade war. Reducing vulnerabilities in supply chains is therefore both a practical and a political problem, and the long-term fragility of the global trading order should be an essential consideration.[46]

Despite the impulse toward protectionism, most states in the international system do not have the ability to onshore substantial amounts of production and will continue to rely heavily on imports and exports for a variety of goods. Indeed, even the largest economic actors – the United States and China – are unable to do so without massive government intervention, which itself would increase prices and create geopolitical shockwaves. But this has not stopped leaders in both countries from contemplating efforts of this sort. As part of his administration's "Build Back Better" plan, President Biden advocates efforts to "buy American, and only American," suggesting he may embrace some of Donald Trump's protectionist impulses. Meanwhile, China has embraced what its leaders call the "dual circulation strategy" and have reportedly issued new procurement guidelines requiring substantial increases in local content for hundreds of government-procured items.[47]

Selective decoupling between China and the United States has been ongoing for some time (after all, Beijing has long banned many US companies from operating in a number of strategic sectors in China), but recent moves threaten to make this decoupling broader in scope and scale. China's dual circulation strategy heralds a shift from Beijing's export orientation to domestic production, distribution and consumption.[48] As Xi Jinping has described, China is repositioning itself as an import instead of an export powerhouse, which "will provide ever larger market opportunities and become a tremendous gravitational field attracting international goods and factor resources," greatly affecting global supply chains.[49] In order to do so, Xi has stressed the importance of China becoming a technological and science superpower.[50] This ambition is also driven by a desire to decrease reliance on foreign sources, which is likely to incentivise greater protectionism, not only in China but beyond as well.

Addressing the risks of economic coercion, influence accumulation, supply chain disruption and propagation of protectionist policies requires a series of interlinked initiatives to manage short- and long-term risks while also balancing economic and security objectives. Doing so necessitates a detailed theoretical framework for assessing these risks and potential response options. This is the task to which we now turn.

THE LOGIC OF AN ALLIED TRUST AND DIVERSIFY STRATEGY

As the preceding discussion demonstrates, the geoeconomic policy domain poses stark trade-offs for governments, both domestically and internationally. The domestic trade-off arises from an inherent clash between the security and economic dimensions of the national interest: a "guns versus butter" debate for the 21st century. National security is costly, whether to the taxpayer when allocating defence expenditures or to the overall economy when policy interventions disrupt the functioning of free markets. Adam Smith famously wrote that free trade is the basis of "the wealth of nations," but the premise of geoeconomic policymaking is that economic transactions and commercial relationships increasingly generate security consequences. Balancing these trade-offs is the key challenge in geoeconomics, requiring cross-agency cooperation and thoughtful policymaking. A fuller understanding of the logic of allied geoeconomic cooperation is an important step in this process.

Conceptualising geoeconomic policy choices

Countering economic coercion and building supply chain resilience are concerns shared by both Australia and the United States. The Biden administration has expressed solidarity with Canberra in countering economic coercion, and the Morrison government is moving quickly on supply chains and issues relating to critical technologies. In May 2021, Canberra created a new Office of Supply Chain Resilience, to monitor vulnerabilities and coordinate government responses to improve access to essential goods.[51] The previous month the government released an updated International Cyber and Critical Technology Strategy.[52] Similar efforts are afoot in the United States, where the White House has created a task force to review supply chain risks. The question now is how to integrate cooperation on geoeconomics more tightly into the workings of the Australia-US alliance.

Geoeconomic policies have real costs, which require policymakers to balance at least three considerations. First, at a basic conceptual level, security policies requiring market interventions – such as imposing tariffs, blocking inbound investments, restricting outbound investment or subsidising diversification – distort market signals and undermine the gains from free and open markets. The historic failures of central planning serve as a reminder that capitalism – open markets, free trade and a relatively light regulatory approach (albeit with important exceptions) – is more conducive to long-term economic growth and prosperity.

THE BIDEN ADMINISTRATION HAS EXPRESSED SOLIDARITY WITH CANBERRA IN COUNTERING ECONOMIC COERCION, AND THE MORRISON GOVERNMENT IS MOVING QUICKLY ON SUPPLY CHAINS AND ISSUES RELATING TO CRITICAL TECHNOLOGIES.

Second, policies blocking certain transactions while allowing others, or otherwise relying on governments to regulate market activity, often give rise to rent-seeking activity. Public interventions create winners and losers, thus encouraging lobbying and other inefficient behaviour. Overuse of government interventions is, therefore, a real risk, especially for societies already struggling over how to regulate large businesses, such as those in the technology sector.

Third, costly interventions disrupting or diverting economic activity may not succeed in mitigating or neutralising the underlying security vulnerabilities and may create new risks. In the simplest example, onshoring production due to concerns about over-reliance on foreign suppliers generates new vulnerabilities to domestic disruptions such as political upheaval, labour market shocks or natural disasters.

Security-motivated market interventions, therefore, create domestic concerns about increased inefficiency, rent-seeking behaviour and vulnerability shifting. Because these security interventions are costly, it is not necessarily straight-

forward to isolate and identify those specific security interests worth paying a price for. Effective policymaking requires identifying the precise vulnerabilities and risks and then designing targeted interventions to minimise broader economic disruptions. Such policymaking will require government structures that integrate a range of perspectives typically located in disparate bureaucratic entities across defence, treasury, commerce, foreign affairs, trade, homeland security and intelligence as well as the business community.

A similar set of dilemmas exists in terms of international policy coordination. Even when states have shared security concerns, their individual economic interests, and their views of the merits of the international economic system, are often at odds. Companies and industries with narrow interests will pressure governments to prioritise self-interest over shared interest. Economic disruptions by trading partners – including both malign coercive actions and good faith supply chain diversification efforts – will create winners and losers behind and across borders.

Differential economic impacts, therefore, incentivise intervention by powerful vested interests, seeding domestic political pressures that can undermine international collaborative efforts. One national industry's loss of market share will be another's gain. Conversely, onshoring production in one country will have ripple effects across international markets and may harm industries abroad, either by eroding market share or raising the prices of inputs. Geoeconomic cooperation, therefore, faces a credible commitment problem: How can governments design mechanisms that promote long-term security interests, yet are robust enough to protect against short-term pressures from individual economic interests?

Unfortunately, existing multilateral institutions are poorly equipped to navigate these geoeconomic dynamics. Consider two examples from the global trade system governed by the World Trade Organization (WTO) and the General Agreement on Tariffs and Trade (GATT). First, while the GATT system contains a specific exception (Article XXI) permitting trade barriers justified by national security considerations, such

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measures have rarely been employed and jurisprudence on their operation is thin. The first legal ruling came only in 2019, during a dispute between Ukraine and Russia, which leaves many questions unresolved.[53] Although the text of Article XXI purports to define the specific circumstances in which trade can be limited for national security reasons, Washington believes many national security decisions should not even be subject to WTO oversight, and also the existing regime is unable to account for the multitude of mechanisms through which security vulnerabilities arise from economic interdependence.[54]

A second challenge is that even when a WTO member institutes a legal complaint – as Australia has done against China by challenging barley tariffs – the legal process can take years to resolve, by which time the economic damage has already been done.[55] Countering coercive and non-transparent violations of international rules requires a more rapid and nimble policymaking framework than available through the WTO system. Washington's own unwillingness to allow the appointment of new members to the Appellate Body has only worsened this problem.

Issues with the WTO system are emblematic of the broader inability of global economic governance to manage two trends. The first is the rise of "state capitalist" models of economic organisation, where distinguishing between private and state-controlled entities is increasingly impossible. State capitalism generates novel security concerns among governments, especially regarding China, which are not yet fully understood.[56] The second trend is the emergence of technologies that have profound consequences for political, economic and social institutions within nations.[57] The current system was built in a pre-digital age, and there is an open playing field for governments – many of which do not share similar values to those of Australia and the United States – to decide how new technologies will be used and regulated. Addressing state capitalism and emerging technologies will require a willingness to rethink some fundamental aspects of the current economic order, which was created in the mid-20th century and is struggling to manage early-21st-century challenges.

Trust and diversify: A framework for geoeconomic cooperation

Australia and the United States need a common framework for approaching geoeconomic cooperation. The strategy advocated here seeks to "trust and diversify." The principle of *trust* recognises certain trade and investment transactions must be based on reliable security and political relationships if they are to endure. This requires the development of certain markets organised around trust in addition to economic complementarity, although this should apply only to as limited a number of sectors as possible, in line with the "small yard, high fence" concept.[58] At the same time, the concept of trust emphasises the need for Australia and the United States to remain respected contributors to an open global economic order, even as that order is necessarily reformed to reflect geoeconomic realities. The goal is to update, not undermine, the global economic system. This means Australian and American government interventions into markets for security purposes must not only be targeted and restrained but also based on public and transparent decision-making frameworks.

The principle of *diversification* acknowledges mitigating risks emanating either from untrusted economic partners or from fragile supply chains will seldom involve simply closing off such relationships and connections. Australia, the United States and others will have to act collectively to push back against non-transparent economic restrictions that are likely being used for coercive purposes in the short term or to generate

benefits intended to be used as strategic leverage over the long term.[59] A sustainable balance is best achieved by diversifying economic partners and thus reducing dependence on any single source, rather than through outright protectionism. Although residual risks will remain, these will be more acceptable given the interest in maintaining an open and rules-based global economic system. Moreover, decreased dependence on untrusted partners will lessen the likelihood those partners can successfully deploy coercive economic leverage for strategic purposes.

A SUSTAINABLE BALANCE IS BEST ACHIEVED BY DIVERSIFYING ECONOMIC PARTNERS AND THUS REDUCING DEPENDENCE ON ANY SINGLE SOURCE, RATHER THAN THROUGH OUTRIGHT PROTECTIONISM.

Trust and diversification require at least three related initiatives. The first is an effort to better understand the existing geoeconomic environment, including which parties can be trusted and which sectors are most vulnerable and require diversification. The second aspect includes efforts to rethink the structure of economic interdependence by relying more on trusted partners and less on untrusted partners. The third element is an effort to identify and respond to specific coercive acts and particular supply chain fragilities. Each of these elements is addressed in more detail below.

Understanding the geoeconomic environment

A simple and relatively uncontroversial starting point for policymakers is to improve situational awareness by providing firms, industries and governments with a more sophisticated understanding of their geoeconomic risk profiles and fragilities. Identifying and managing these dangers require the expansion of government capability and capacity, including within the intelligence community, to understand the risk environment and align risk tolerance – the level of desired economic resilience – accordingly. This process involves assessing which countries and companies can be trusted and, within both trusted and untrusted economic relationships and networks, identifying those industries and supply chains that are most vulnerable to coercion or are insufficiently resilient to various types of disruptions.

Having pinpointed vulnerabilities and fragilities, the second task is to expand situational awareness. For leverage concerns, this means efforts to monitor the regulatory environment and corporate landscape to identify areas in which regulatory tools could be wielded against vulnerable entities in a market-distorting fashion for strategic purposes.[60] Beijing seldom disrupts commerce when the expected costs to its own industries and workers are high. This means the most vulnerable industries are often nationally branded consumer products that are easily substitutable.[61] While Beijing's sanctions are rarely enshrined in law, they often rely on the use of other legal instruments – such as customs rules and safety regulations – as fig leaf justifications to restrict commercial activity. Expanding understanding of these patterns of behaviour is critical to developing support for implementing countermeasures. Meanwhile, it is also necessary to map supply chains and gather information about best practices in supply chain management to better comprehend risks emanating from fragility.

Each country will have to conduct these assessments individually, given that risk profiles will differ based on particular political relationships and economic structures. But allied cooperation in these domains will be necessary as a result of the substantial informational demands involved. To be most effective, countermeasures and resilience-building policies also require coordination prior to enactment. The broad objective of these policies would be ensuring vulnerable industries

are aware of geoeconomic risks, are in regular communication with the government and are actively working to minimise their vulnerability.

Rebalancing risk through diversification

Having mapped industries and their inherent vulnerabilities, the next step is to measure the extent of countries' reliance on untrusted markets and fragile supply chains. This assessment should take into account industries' and companies' terms of production, revenue and profits. Although disruption might constitute a minor inconvenience for some firms, it could put others out of business. Governments need to prioritise those industries and firms whose exposure to untrusted parties or fragile supply chains poses the greatest risk to their commercial viability or the broader national interest. Officials will have to work with businesses to explore ways for them to diversify or expand their operations in other markets, or otherwise increase flexibility and improve their resilience to political and other risks.

There is no single template for diversification. Sometimes diversification will be an automatic market reaction to barriers to trade.[62] In other cases, complementarities with certain large markets and deeply embedded supply chains will be impossible to replicate elsewhere, or the costs of shifting operations will be too great, especially for small and medium-sized enterprises. In these cases, greater flexibility might involve more engagement with local stakeholders who could help insulate businesses from political tensions. This could mean joint operations with local firms or partnerships with local governments, all while maintaining the most up-to-date situational awareness. It could also include market incentives for multinational firms to relocate, reducing their costs.

From an alliance standpoint, diversification efforts might also mean joint efforts to work bilaterally, and with other trusted partners, to alleviate key chokepoints and provide other market options. Given that political and supply chain risks to one ally can impact both parties (or more in a multilateral setting, such as has been the case with the North Atlantic Treaty Organization), allies will increasingly have to work together to rebalance the risks inherent to economic interdependence. This will often mean that governments with larger economies will have to work proactively to help smaller and more vulnerable economies manage geoeconomic risks.

Responding to incidents of economic coercion

In a general sense, coercion can be countered in one of two ways.[63] The first is *deterrence*, which is commonly defined as discouraging an opponent from taking an action by convincing that opponent the expected costs or risks outweigh prospective gains.[64] Deterrence is most effective when conducted before a coercive campaign has begun since compelling change to ongoing actions is often more difficult than dissuading an opponent from launching a coercive action in the first place. Deterrence aims to shift the cost-benefit calculus of the coercer, so the coercer is either unable to achieve its objectives or can only do so by bearing an unacceptably high cost.

The second method to protect against coercion is *loss mitigation*, which focuses on preventing or reducing the amount of losses caused by a coercive act. Loss mitigation aims to protect those who would be directly harmed, which in turn alleviates the coercive act's political pressure on the target government, company or individual. Loss mitigation can reduce the exposure of potential pressure points or remedy losses suffered during or after an event.

Regardless of whether a government is aiming to deter or mitigate losses, the first challenge is *attribution*. Effective countermeasures typically require the ability to clearly identify and convincingly attribute illegitimate behaviour. This often seems simple in the case of formal and explicit sanctions, but distinguishing informal sanctions is difficult because all international trade involves daily frictions, including misunderstandings and inadvertent failures to comply with regulatory requirements. For example, defective products, which are wholly unrelated to political discord or intentional coercion, should rightly be barred from sale, but these excuses can also be used to coerce.[65] Any countermeasures must distinguish between such quotidian frictions and true instances of intentional coercion via informal sanctions.

Attribution requires a consistent and transparent rules-based framework to make these distinctions. Policymakers will need to develop principles and evidentiary standards that meet an objective threshold that triggers countermeasures. Such a framework will likely use international trade law as a starting point but will need to articulate new standards to reflect the inherent uncertainty surrounding informal sanctions and the need to respond with speed and decisiveness. One possibility would be for industries suffering losses to apply to a quasi-judicial national authority and present a credible case of economic loss due to political interference. Once a particular threshold is met, the burden of proof could then shift to the offending government to explain why a disruption was legitimate. Ideally, the creation of national mechanisms would be coordinated to harmonise international cooperation on attribution. The design of such mechanisms raises many complex questions and should be informed by and pursued in parallel with the existing process under the WTO.

As this discussion makes clear, there are several steps that governments should take to address geoeconomic challenges. Some of these, such as risk assessments, are likely to be done unilaterally. Others, such as diversification, may be best done through bilateral and mini-lateral agreements. Finally, a subset of efforts to counter coercion will require broader multilateral frameworks, such as efforts to formalise coercion attribution. The following section explains how Australia and the United States can use the trust and diversify framework to start implementing a set of policies that would take up these tasks and establish a new framework for addressing today's geoeconomic challenges.

RECOMMENDATIONS FOR ALLIED GEOECONOMIC COOPERATION

The Australia-US alliance is a promising laboratory to pioneer new mechanisms of geoeconomic cooperation. There are at least three preconditions for successful international cooperation on geoeconomic issues. First, the parties need high levels of trust to maximise the credibility of long-term commitments, which require shared assessments of the nature and severity of security threats. Second, the parties require mechanisms to minimise or mitigate inevitable divergences in economic interests. Third, cooperation requires some means to convene the range of specialist expertise necessary to understand, forge a consensus on, and tailor policy solutions that balance security and economic trade-offs. The Australia-US alliance satisfies each of these conditions.

Canberra and Washington are deeply integrated across military, intelligence and foreign policy domains, with the two nations sharing similar perspectives on the nature and scope of today's geoeconomic challenges. The allies have built up mutual trust over the last century, which opens the way to pioneering new initiatives. Moreover, the structure of the two economies is relatively complementary, with fewer areas of competitive overlap compared to other advanced economies. These complementarities minimise (but do not eliminate) sources of economic friction that can undermine cooperative endeavours. Perhaps most importantly, the alliance offers an existing institutional framework and bureaucratic architecture that could be extended beyond the traditional focus on foreign and defence policy to integrate economic and financial expertise into a broader geoeconomic agenda.

Nonetheless, the Australia-US alliance is not, at the moment, postured to deal effectively with geoeconomic challenges. The alliance has been rightly focused on security issues for most of its tenure, but the fundamental tension in geoeconomic policymaking is the trade-off between economics and security. This is sometimes described as a choice between the wealth and prosperity generated by open markets and economic globalisation, and the risks and vulnerabilities inherent in historically unprecedented levels of interdependence. How policymakers resolve this tension between "fear and greed," as former Prime Minister Tony Abbott once colourfully described it, will have major implications for the durability of the international economic order and the stability of the international system.[66] The following recommendations suggest policies that the two governments should consider in order to prepare the alliance for today's geoeconomic challenges.

Expand AUSMIN to address geoeconomic issues

At present, the 2+2 format of the Australia-US Ministerial Consultations (AUSMIN) has an overwhelming focus on the portfolios of the participating principals: the Australian Ministers for Foreign Affairs and Defence, as well as the US Secretaries of State and Defense. Officials from the two nations do collaborate closely on economic matters, but within relatively siloed bureaucratic relationships, such as the Reserve Bank of Australia with the Federal Reserve, and the Australian Department of Treasury with the US Departments of Treasury and Commerce. In addition, the Australian Department of Home Affairs and the US Department of Homeland Security have been active in a mini-lateral format with the United Kingdom, Canada and New Zealand.

The next step is for Canberra and Washington to expand AUSMIN into a true strategic and economic dialogue, into which the full range of geoeconomic policy issues would be incorporated. That would mean delegating key members of both governments responsibility for different aspects of geoeconomic policy. Future AUSMIN meetings should not simply be 2+2 summits of

defence and foreign policy makers, they should expand to 3+3 arrangements that also include officials from the Treasury and perhaps others as well. Prime Minister Morrison has proposed a separate Strategic Economic Dialogue, but it is critical that geoeconomic issues be integrated into the lifeblood of the alliance, not dealt with separately. Thus, if adding a third minister to AUSMIN is not feasible, then AUSMIN should be retooled to become a series of dialogues, with at least one specifically focused on geoeconomics in recognition of how closely intertwined economic and security issues have become. After all, if geopolitics is central to the Australia-US alliance, then AUSMIN is incomplete without the inclusion of economic leaders.

Establish a joint working group on geoeconomic cooperation

Although integrating geoeconomics more fully into AUSMIN would send an important signal, the two governments cannot rely on episodic meetings alone – they need an ongoing mechanism focused on day-to-day collaboration to address short- and long-term geoeconomic challenges. This report has conceptualised these issues through the twin lenses of leverage and fragility. However the core topics are framed, there is a need for an institutionalised dialogue to develop both baseline conceptual language around, and a joint policy agenda on, the nature of the problem. In other words, the allies need to decide what is practically possible to counter coercion and mitigate supply chain disruptions in the short term, while striking a durable long-term balance between economic opportunity, trade dependency and strategic risk. And they must do all this while preserving the integrity of the rules-based economic order.

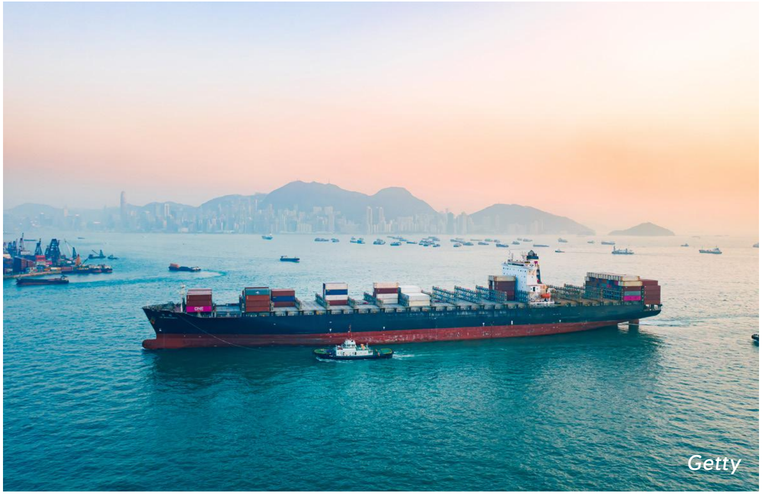
With this in mind, the two governments should establish a working group on geoeconomic cooperation, incorporating officials from both the security and economic bureaucracies. The working group's first task would be to agree on the nature of the policy challenges by sharing information and assessments regarding each country's key areas of vulnerability. Shared baseline understandings could then feed back into the AUSMIN process as a starting point for more challenging work on specific policy initiatives. A successful bilateral process could, in turn, set the agenda for expanded cooperation with other key countries, or merge with ongoing efforts involving partners such as Japan, South Korea, Canada, the United Kingdom and the European Union. Building such mini-lateral and multilateral arrangements will take time, but the urgency of the challenge merits convening a bilateral working group to start cooperating on these issues today.

Develop a cooperative supply chain management agenda

Immense political momentum to act on supply chains is beginning to manifest, both nationally and increasingly internationally. In their June 2021 Summit Communique, G7 leaders stated they would "consider mechanisms and share best practices to address risks to the resilience of critical supply chains."[67] The Biden administration's 100-day review noted that the United States "cannot address its supply chain vulnerabilities alone" and had a strong interest in "ensuring its allies and partners have resilient supply chains as well."[68] The challenge is translating this momentum into tangible policy outcomes that, as discussed above, balance the need to mitigate vulnerabilities with the necessity to preserve the rules-based trading order.

The alliance framework, enabled by an expanded AUSMIN and a working group on geoeconomic cooperation, would provide the institutional incubator needed to develop a supply chain management agenda. Canberra and Washington, backed

by an underlying relationship of trust, should look to map vulnerabilities and experiment with short-term policies to mitigate specific risks. These efforts should seek to balance longer-term priorities such as improving the operation of markets against efforts to avoid protectionist and rent-seeking impulses. Washington could also take a first step in demonstrating its trust in Canberra by placing Australia on its permanent Committee on Foreign Investment in the United States (CFIUS) White List, a status that is set to expire in February 2022.[69] Recommitting to a "free and open" trade and investment construct for the Indo-Pacific should be a key element of such an approach.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Construct an attribution mechanism to identify coercion

After establishing processes to form a shared conceptual framework, the next step will be to establish mechanisms to coordinate concrete action which, in the geoeconomic domain, is complicated by cross-cutting economic interests. Identifying informal economic coercion is a prerequisite to any efforts to build support for bilateral or multilateral initiatives to push back against violations of geoeconomic norms. Beijing's increasingly brazen coercive economic measures have thus far faced little resistance from a multilateral framework that is not fit for purpose. Although it would be ideal to use the World Trade Organization to police this type of coercive behaviour, it is clear that another mechanism will be required, at least in the short term.

Australia and the United States should jointly develop principles and lead the formation of a multilateral grouping that can identify when an economic decision or incident has crossed the line from "normal" competitive frictions into coercive behaviour. Planning could begin bilaterally, with a view to expanding to the other D10 countries – Canada, France, Germany, India, Italy, Japan, South Korea and the United Kingdom – all of which have faced concerns about economic pressure from China. This shared assessment would make attribution easier, put reputational pressure on Beijing via "naming and shaming," and accelerate efforts to develop and apply multilateral countermeasures. If multiple jurisdictions develop a similar rules-based institutional mechanism for responding to coercion, it will serve not only as a deterrent but also form the basis for reforming existing international architecture to handle these issues. Ultimately, the only way to convince malign actors to stop engaging in coercive behaviour may be to impose costs on them for doing so. This may not be politically possible for some time but creating an attribution mechanism is an essential first step that should be pursued today.

Explore cooperative countermeasures against economic coercion

After coordinating threat assessments and developing a multilateral attribution mechanism, it will then be possible to consider specific countermeasures against cases of coercion. One proposal is an "Economic Article V" in

which economic coercion would be met with "collective defence" through retaliatory tariffs. Others suggest governments should support each other through financial outlays, such as the United States creating a "strategic shiraz reserve" in response to Chinese sanctions on Australian wine.[70] Neither approach seems politically realistic in the near term.[71] For the time being, the expectation should be that loss mitigation efforts will be undertaken at the national level, with political leaders looking to assist the industries, firms and individuals most harmed by coercive pressure. The European Union is, for example, in the process of drafting its own "anti-coercion instrument."[72] Larger economies may also develop limited retaliatory capabilities, though these may impose significant costs with an uncertain deterrent effect.

CANBERRA AND WASHINGTON TOGETHER DEVOTE SUBSTANTIAL RESOURCES TO DETERRING MILITARY CONFLICT BUT GEOECONOMIC CHALLENGES ARE EXPOSING THE ALLIANCE'S SOFTER ECONOMIC UNDERBELLY.

In the longer term, there remains scope for allied cooperation. Australia and the United States should have two objectives in this regard: first to compel the coercer to end its damaging activities, and second to dissuade further coercive actions. An ambitious goal for the future would be to create a counter-coercion fund to mitigate losses. Such a step is not achievable today but it is possible to begin building the economic logic and political support that could justify this type of effort in the future. Such a fund might be small at first, aiming not to fully compensate those targeted by coercion but to instead send a signal of political support to vulnerable allies and partners and the private sector. This would limit the effect of geoeconomic coercion, thereby disincentivising future coercive behaviour and increasing the resilience of the private sector to economic coercion. Over the next few years, Australia and the United States should look to build this as a voluntary mechanism among interested parties, and then expand participation over time (all while updating World Trade Organization rules to permit these types of necessary security-enhancing interventions).

Conclusion

The long record of Australia and the United States meeting every major struggle together is now at risk. The Australia-US alliance finds itself ill-equipped to meet the full range of 21st-century challenges, particularly those relating to geoeconomics. Canberra and Washington together devote substantial resources to deterring military conflict but geoeconomic challenges are exposing the alliance's softer economic underbelly. Australia is under constant geoeconomic pressure, which seeks to weaken not only Australia but also its alliance with the United States and their shared commitment to a rules-based order. Leaders in both countries, therefore, have an opportunity – indeed a responsibility – to update the alliance framework to address today's geoeconomic threats.

The "trust and diversify" strategy advocated here aims to utilise the alliance to respond to four key risks posed by economic interdependence: geoeconomic coercion, influence accumulation, supply chain disruption and propagation of protectionism. Bilateral initiatives in each of these areas should be seen as the first steps toward the longer-term objective of a consolidated multilateral response that includes partners across the Indo-Pacific and around the globe. Washington and Canberra have often touted their long history of cooperation as an example to others. On its 70th anniversary, the alliance's leaders must renew this commitment by executing America's promise "not to leave Australia alone on the pitch."

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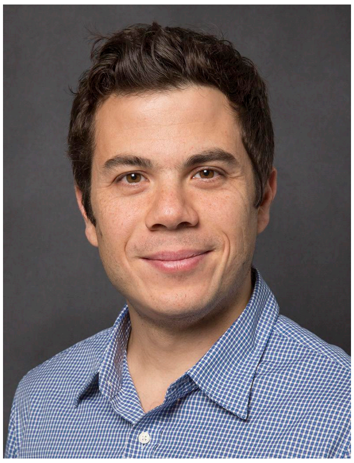

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